



AR 35



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The Quaker Oats Company

In this centennial year of the trademark of The Quaker Man, the cover of our annual report features products that represent the Company's major lines of business.

Highlighted on the front cover is the U.S. Grocery Products Area, which includes traditional Quaker Oats and other hot and ready-to-eat cereals; Quaker Oatmeal Cookie Mix; Aunt Jemima mixes, syrup and frozen foods; Celeste frozen pizza; and Ken-L Ration and Puss 'n Boots pet foods.

Also featured on the front cover is the International Grocery Products Area, products of which are sold throughout the free world, and include cereals, pet foods, mixes, nutritional beverages, chocolate bars and canned seafood.

The five divisions that make up the Diversified Businesses Area are represented on the back cover. They are Fisher-Price Toys, Magic Pan Restaurants, the Chemicals Division, Burry cookies and crackers, and Needlecraft art and craft kits.

Thousands of Dollars

Year Ended June 30	1977	1976	Percent Increase (Decrease)
Net sales	\$1,551,348	\$1,473,052	5.3
Operating income	148,098	124,312	19.1
Interest expense-net	12,909	13,426	(3.9)
Income before income taxes	135,189	110,886	21.9
Net income	67,574	53,093	27.3
Preferred and preference dividends	5,146	5,206	(1.2)
Net income available for common	62,428	47,887	30.4
Per Share			
Net income per common share	\$3.01	\$2.31	30.3
Preference dividends declared	9.56	9.56	—
Common dividends declared	.92	.84	9.5
Common Stock			
Average shares outstanding	20,762,440	20,711,092	.2

Robert D. Stuart, Jr., Chairman and Chief Executive Officer, and Kenneth Mason, President and Chief Operating Officer.



To Our Shareholders and Employees:

One hundred years ago today, the official registration of The Quaker Man trademark was issued by the U.S. Patent Office. We are extremely conscious of the heritage this valued trademark represents. Now, a century later, it's gratifying to report to you the results of our 1977 fiscal year, the best year in our history:

□ Earnings were \$3.01 a share, a 30.3 percent improvement over the \$2.31 we reported last year, when our results included a 57 cents a share write-off in connection with the sale of Marx Toys. Sales of continuing businesses improved 9 percent, but operating income was 7 percent below a year ago, due to major problems in the Chemicals Division.

□ We achieved fine results in our U.S. Grocery Products business, on top of the previous record year in fiscal 1976. There were good unit volume increases in several product lines — particularly in ready-to-eat cereals.

□ Our International Grocery Products business did well in fiscal 1977, with growth in physical volume, sales dollars and profits. Our progress in the rapidly expanding European pet foods market continues to be encouraging. In Latin America, where consumer food products include many growth categories, our results were excellent. The well balanced Canadian foods and pet foods business had another good year.

□ Fisher-Price Toys produced record results. The division continued to expand its market both geographically and in the age-range of its products. Trade acceptance of our toys for Christmas, 1977, continues high.

□ There was a significant expansion in the number of our specialty Magic Pan Restaurants, which represent a promising growth area. Operating

income in this profitable business was slightly below a year ago due to the high rate of new restaurant openings, soft sales in the third quarter resulting from severe winter weather, and margin pressure primarily because of payroll costs.

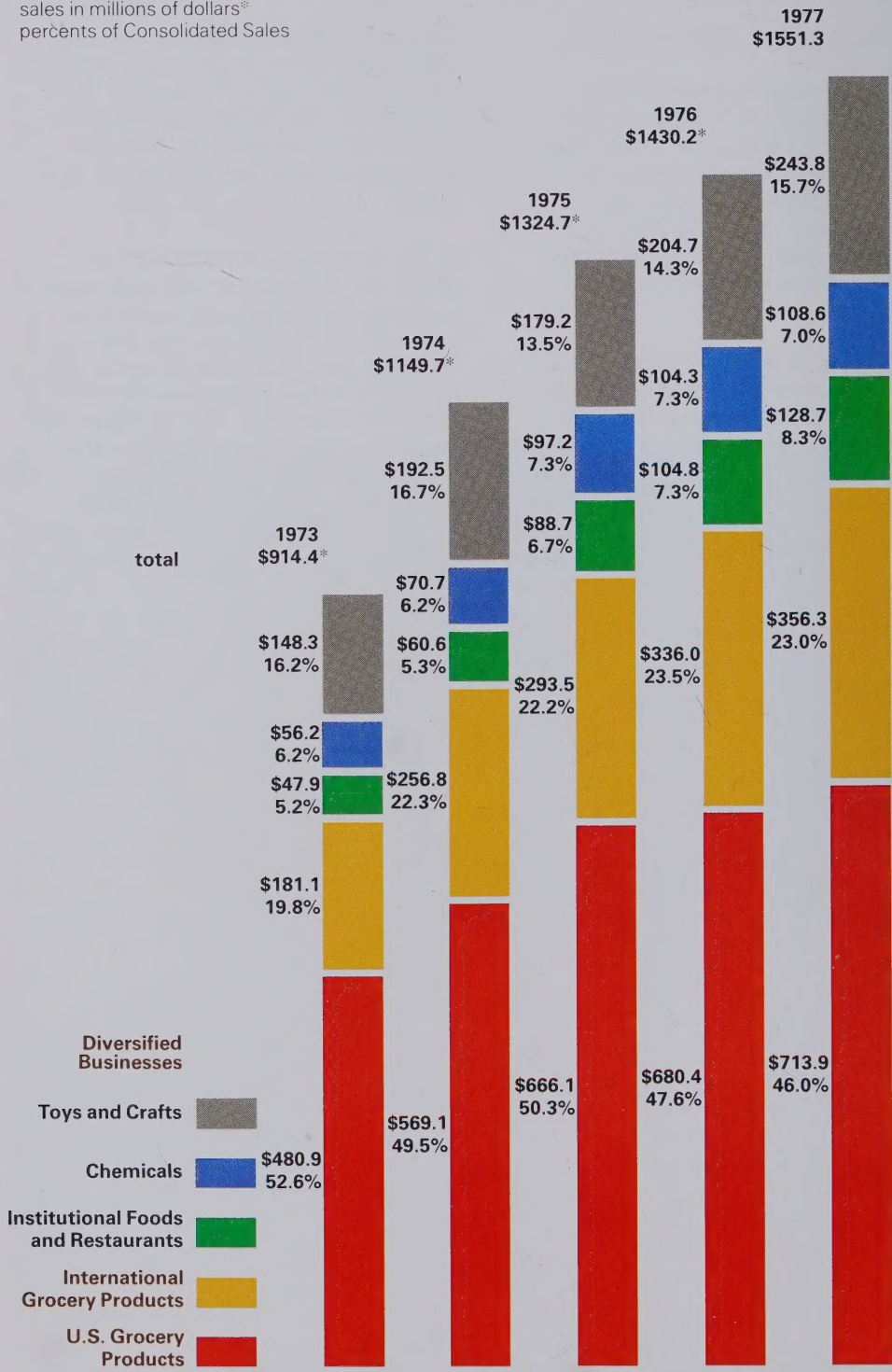
□ The disappointing results of the Chemicals Division was our most serious challenge during the year. Chemicals had an \$8.8 million operating loss, including about \$3 million in write-offs, compared to operating income of \$11.8 million in fiscal 1976. Management was changed, operations were trimmed where appropriate, marketing was strengthened, and the division has made progress toward correcting its problems. For the full year, physical volume was off 7 percent from last year, but in the second half of fiscal 1977, volume was 14 percent ahead of the comparable period last year, which we believe was the low point in the slump. We continue to be confident of the longer-term potential of this area of important investment, but recognize that time will be required to restore significant levels of profitability and an adequate return on investment.

□ We continued to strengthen our financial position. In September, 1976, the common stock dividend was increased for the tenth consecutive year. A strong cash position during the year influenced the Directors' decision to redeem the \$3 cumulative convertible preferred stock.

□ We implemented a unique employee stock plan to give five shares of common stock to Quaker men and women in the U.S. with at least five years of service. We believe this additional incentive for some 7,300 U.S. employees who are now part owners of the business is highly desirable for any large publicly held company. In particular, we've been pleased with the number of employees who are reinvesting their dividends in

Consolidated Sales

sales in millions of dollars*
percents of Consolidated Sales



*The following sales for the Marx operations sold are not included in the totals.

1973	1974	1975	1976
\$76.4	\$77.6	\$64.3	\$42.8

additional shares of Quaker common stock.

We're encouraged by the strength of our basic businesses and our new product development program. To take advantage of market opportunities in both established and new grocery products, we've scheduled heavy spending in the early part of fiscal 1978. Because this spending level is considerably higher than last year, we expect first-quarter earnings to be well below the record first quarter last year. For the 1978 fiscal year as a whole, however, a good earnings increase over fiscal 1977 is expected.

Management changes put into effect during the year have strengthened the Company at key levels and are providing broad experience to younger managers who will lead the Company in the future.

We particularly want to thank our Board of Directors, who spend large amounts of time on the business and help in formulating our corporate strategies.

As we look ahead in fiscal 1978 and beyond, several fundamental factors are important:

☐ During the past ten years our earnings per share have increased at a compound rate of 12 percent. For the past five years, this rate is 11 percent.

☐ The U.S. economy, which is the biggest market for our products, appears strong and steady. The favorable crop picture is expected to reduce the rate of inflation and help ingredient costs in our largest business, U.S. Grocery Products.

☐ While there are varying degrees of inflation and political stability overseas, our experienced managers have demonstrated over a number of years that our businesses can be managed profitably under volatile circumstances.

☐ There is a worldwide interest in better nutrition. With strong new direction and support for new product development, we believe Quaker is

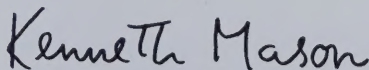
well positioned to capitalize on these opportunities.

☐ With the continuing strength of our financial position, we are planning to make major investments to broaden our existing businesses and expand the Company's total portfolio.

☐ At a time when many institutions have been hurt by questions of honesty and ethics, our Company has a precious asset in its heritage of integrity. That heritage, as our centennial trademark anniversary demonstrates, is a hundred years old. It remains a fundamental strength to which we are totally committed and of which we are extremely proud as we look confidently to the future.



Robert D. Stuart, Jr.
Chairman and Chief Executive Officer



Kenneth Mason
President and Chief Operating Officer

September 4, 1977

6 **U.S. Grocery Products Area**

sales in millions of dollars
percents of Consolidated Sales



U.S. Grocery Products, the largest of Quaker's five lines of business, generated 46 percent of consolidated sales and 59 percent of total operating income in fiscal 1977.

The chart on the facing page shows the five-year sales growth of the U.S. Grocery Products Area. For the same period, operating income has grown at a compound annual rate of 16 percent to its present all-time high. Last year's significantly improved operating income margin was maintained in fiscal 1977.

Costs of agricultural commodities and certain other raw materials were lower than last year and favorably influenced fiscal 1977 results. In addition, cost-reduction programs had a pronounced positive impact on earnings. Advertising and merchandising expenses were up 21 percent, and will again be up significantly in the current year — particularly in the first quarter as new product introductions continue. The most important of these is Ken-L Ration Tender Chunks, Quaker's entry to compete in the dry dog food category. Our marketing focus is on areas of growth and high consumer interest — pet foods, ready-to-eat cereals, frozen pizza and cookie mixes, among them. Increasing our market shares of these dynamic businesses will continue to require substantial promotional expenditures.

Foods Division

The largest operating division within the Company, the Foods Division manufactures and markets most of Quaker's consumer food products sold in the United States. Its sales of \$495 million in fiscal 1977 were about one third of total Company sales, and the division is the Company's largest contributor to operating income. While much of this business is in the

large, stable cereals and mixes categories, there are several specific lines of products that have good growth prospects, including ready-to-eat cereals, whole-grain food products, specialty mixes and frozen foods.

Hot Cereals

Hot-cereals volume in fiscal 1977 was off slightly from a year ago, but Instant Quaker Oatmeal, which is benefiting from strong consumer interest in whole-grain foods available in a convenient serving form, continues to grow. Available nationally in five flavor variations, it is achieving important sales increases as more and more adults and children are attracted to this hearty breakfast food, which is quick and easy to serve. A new flavor — Bran and Raisin Instant Oatmeal — is now being introduced on a regional basis. Sales volume of traditional Quaker Oats was off modestly.

Hot Cereals	(millions of dollars)
77	\$104.0
76	\$99.2
75	\$94.9
74	\$69.4
73	\$62.9

Ready-to-Eat Cereals

Ready-to-eat cereal results for the year were excellent, experiencing double-digit volume growth in a strongly competitive market. Cap'n Crunch products and Life cereal have important and improving shares of the cereal business. A cinnamon-flavored Life went into test market during the year, and distribution is now being expanded. While the natural cereal category has declined substantially from its high level

of sales two years ago, Quaker 100% Natural Cereal continues to hold the leading share and makes an excellent contribution to profit.

Ready-to-Eat Cereals	(millions of dollars)
77	\$135.8
76	\$122.9
75	\$116.1
74	\$102.6
73	\$77.6

Mixes, Syrup and Corn Products

Mixes, Syrup and Corn Products were about the same as fiscal 1976 in total volume. The positive factor was the successful introduction of Quaker Oatmeal Cookie Mix, which rose to the leading position in its specialty market. To capitalize on this success, three additional flavor varieties have recently been announced. Several Aunt Jemima and Quaker pancake, baking and cornmeal mixes, on the other hand, experienced volume declines from the unusually high sales levels achieved during the past two years when consumers, influenced by recessionary conditions, sought inexpensive, basic food products rather than convenience. Aunt Jemima Syrup has improved in volume and market share despite industry weakness, and is currently at an all-time high.

Mixes, Syrup and Corn Products	(millions of dollars)
77	\$144.1
76	\$136.2
75	\$134.3
74	\$100.5
73	\$81.5

Frozen Foods

Frozen Foods volume increased modestly during the year — particularly the Aunt Jemima breakfast and batter products category. Because an extremely vigorous competitive climate exists in frozen pizza, which continues as one of the fastest-growing segments of the U.S. grocery industry, higher levels of advertising and merchandising spending were committed to Celeste Frozen Pizza. A new mushroom variety was introduced during the year, and a thick-crust Celeste Sicilian Pizza went into regional distribution at fiscal year-end. Adequate profitability in frozen foods remains a principal objective as we pursue this growth area. The Jackson, Tennessee, frozen foods plant and distribution center — one of the most modern and efficient in the industry — is a decided asset in pursuing this objective.

Frozen Foods	(millions of dollars)
77	\$64.9
76	\$60.9
75	\$54.5
74	\$49.7
73	\$40.6

Other Foods

This category includes sales of Wolf Brand canned chili products in the southwestern part of the United States, principally in the state of Texas. Though modest in sales, Wolf Brand continues to be a very successful business. Also included are sales of certain cereals and grain by-products.

Other Foods (millions of dollars)

77	\$45.7
76	\$46.4
75	\$48.9
74	\$44.8
73	\$44.2

Pet Foods Division

U.S. Pet Foods, the second largest Quaker division, significantly improved its profitability in fiscal 1977, while preparing for the introduction of Ken-L Ration Tender Chunks into the dry dog food market.

Dog Foods

Total dog food volume was level with last year. Ken-L Ration burger-type products were about the same, while Ken-L Ration Special Cuts volume was up markedly as a result of new marketing strategies tested during the year. A Liver & Bacon variety of Ken-L Ration Burger, introduced nationally in February, is selling very well, and a new Puppy Burger product is now in test market. Reflecting industry trends, canned maintenance dog food sales were off, although they continued their substantial contribution to division profits. A beef-flavored canned dog food, introduced in February, is exceeding expectations. New Ken-L Ration Chunky Dinners canned dog food is now being test-marketed in the fast-growing premium quality segment.

Ken-L Ration Tender Chunks went on the market in 30 percent of the U.S. toward the end of fiscal 1977, and was expanded to 50 percent of the nation in the first quarter of the current fiscal year. It is a unique product designed to compete

in the dry dog food category, the high growth segment of the dog food market. Vigorous competition in this market requires that substantial amounts of advertising and merchandising be committed, and the Company plans to support the introduction of Ken-L Ration Tender Chunks with heavy promotional spending. To supply product for this new venture, construction of a fourth U.S. pet food plant in Lawrence, Kansas, is underway.

Dog Foods (millions of dollars)

77	\$183.0
76	\$175.9
75	\$177.6
74	\$163.5
73	\$139.2

Cat Foods

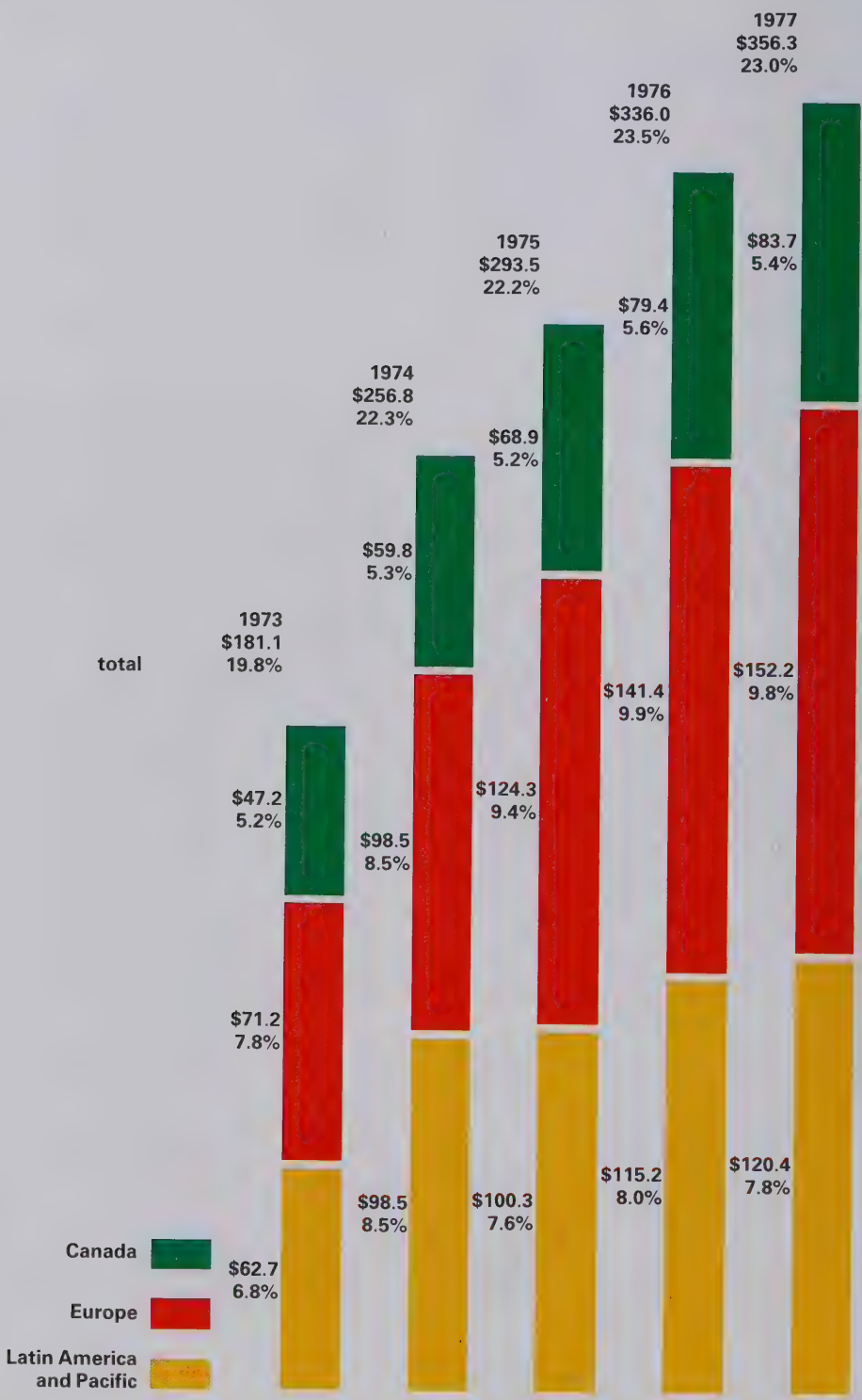
Total cat food volume was down for the year. Our principal product, Puss 'n Boots canned maintenance cat food, is the leader in its field, but competes in a category where sales are declining. For this reason, we are pleased by the progress of Puss 'n Boots Moist Meals, which sells in the faster-growing semi-moist segment, and was expanded to more than half the country during fiscal 1977.

Cat Foods (millions of dollars)

77	\$36.4
76	\$38.9
75	\$39.9
74	\$38.6
73	\$34.9

10 **International Grocery Products Area**

sales in millions of dollars
percents of Consolidated Sales



The International Grocery Products Area manufactures a variety of grocery products, principally foods and pet foods, in Canada, Europe, Latin America and the Pacific, and markets products throughout the world. Canada and the United Kingdom together account for more than forty percent of total Area sales.

Quaker's intent is to employ its product development, manufacturing and marketing resources in ways that best meet the needs and customs of the areas where we do business. Thus, we are concentrating our efforts on foods and beverages in Latin America, while pet foods represent the major growth opportunity for Quaker in European grocery products.

In fiscal 1977, International Grocery sales in U.S. dollars were up 6 percent, and operating income improved 4 percent—both to new record levels—reflecting increases in volume and favorable product mix as well as necessary inflation-related price adjustments. This track record—in spite of severe inflation in some countries, currency fluctuations, and varying forms of government price controls—is very reassuring as we continue to expand our international grocery business under proven Quaker managers.

Canada

The Quaker Oats Company of Canada achieved all-time high sales and earnings in the fiscal year, despite generally difficult economic conditions in Canada. The Canadian company is a very well—balanced grocery products business, which continues to place heavy emphasis on new products. The business is about evenly divided between foods and pet foods.

Canada (millions of dollars)



Europe

The principal thrust of the Company's growth in Europe continues to be in pet foods in Britain, France and the Scandinavian and Benelux countries, with cereals and other foods providing relatively stable sales and earnings. Volume increases were recorded in all European markets. However, the

profitability of our businesses in the United Kingdom and France was disappointing; although the French business showed good growth and its future looks promising.

Europe (millions of dollars)	
77	\$152.2
76	\$141.4
75	\$124.3
74	\$98.5
73	\$71.2

Latin America and the Pacific

Cereals and mixes as well as grain-based beverages are marketed by subsidiaries in Central and South America. Several of these Quaker companies also specialize in other grocery product areas — chocolate beverages and candy in Mexico, canned seafood in Brazil, and household cleaning products in Venezuela.

Sales and earnings of La Azteca, our Mexican subsidiary, were satisfactory on a local currency basis, but results in U.S. dollars were affected by the 45 percent devaluation of the Mexican peso early in the fiscal year. Because of the devaluation, earnings in pesos must now be roughly double what they were previously to produce the same results in U.S. dollars. In addition, the chocolate business has been troubled by a critical shortage of cacao beans for the Mexican market. It will be the second quarter of fiscal 1978 before this problem can be alleviated with the harvest of a new Mexican crop. Considering these problems, our Mexican grocery business produced very respectable results in fiscal 1977.

Elsewhere in Latin America, volumes in all countries were up over the prior year, and earnings established a new record. The seafood business in Brazil improved despite strong competition, and the oats and corn products businesses in other countries were very good. In Australia, volume was up modestly.

Latin America & Pacific (millions of dollars)	
77	\$120.4
76	\$115.2
75	\$100.3
74	\$98.5
73	\$62.7

The Diversified Businesses Area has three lines of business, and includes several promising growth categories.

Area sales were \$481.1 million, up 16 percent from last year, but operating income of \$37.2 million was off 30 percent due to the Chemicals Division loss.

Fisher-Price Toys

Fiscal 1977 sales were up 17 percent, to \$196 million, and operating income increased very significantly. The division had an excellent year.

Fisher-Price	(millions of dollars)
77	\$196.0
76	\$168.1
75	\$146.9
74	\$166.0
73	\$119.8

Though Fisher-Price products sell well year-round, roughly two-thirds of its toys are purchased for the Christmas season. Trade sales were brisk in the period leading to Christmas, 1976, and retail movement was excellent. The off-

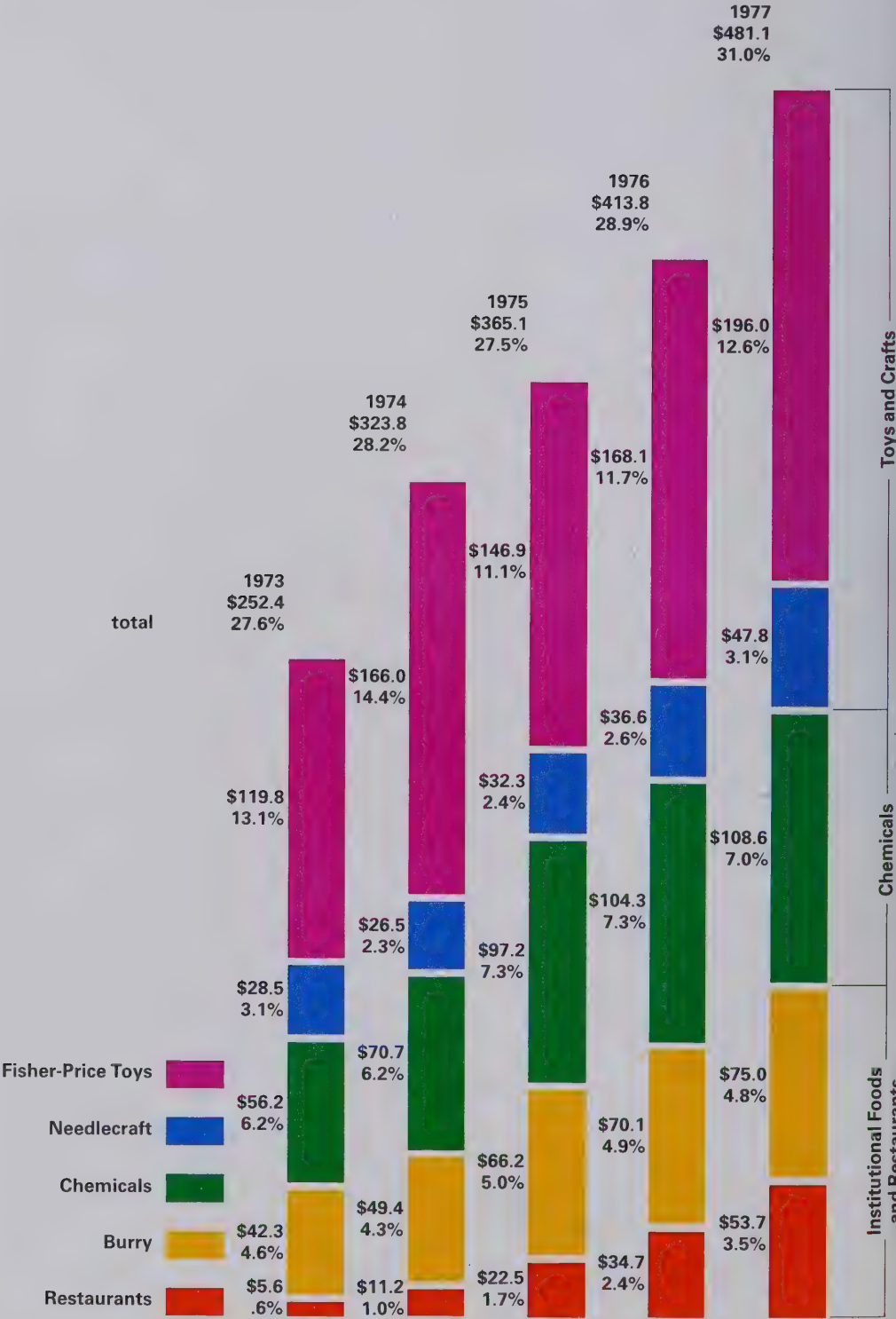
season, from January to June, was also encouraging, with sales increases of 25 percent over the year-ago period.

Preschool toys continue as the mainstay of the Fisher-Price franchise. New products include the Play Family Lift & Load Depot and Sesame Street Clubhouse, as well as three Muppet toys, patterned after the very popular television puppets of that name. In marketing toys related to popular television figures, Fisher-Price is interested only in those of high value and enduring qualities, not in passing fads.

Consumer acceptance of the Fisher-Price hand-held Movie Viewer has been excellent. This year the division introduced its Movie Viewer Theatre, which allows children to show film cartridges of short Walt Disney or Sesame Street features in a simulated small theater. The technology employed in these products was developed by Montron Corporation, a California company that we acquired in January, 1977. Montron is a leader in audio-visual systems that are readily adaptable to toy designs. Under Fisher-Price management, Montron is positioned well to contribute to the division's expanding audio-visual toy business.

14 Diversified Businesses Area

sales in millions of dollars
percents of Consolidated Sales



Growth at Fisher-Price is planned to occur both in product age-range and in the geographic expansion of markets served. The division's Crib & Playpen infant toys, introduced in 1973, are now the industry leader in the birth-to-18 months market. More than nine million Crib & Playpen products were sold last year. The Adventure People line consists of action toys for children aged four to nine.

Fisher-Price is expanding effectively internationally; about 30 percent of the division's business is now outside the United States. In Canada, the division has an extremely strong and growing business. In Mexico, the Plastimarx subsidiary has added several Fisher-Price toys to its existing line and is now the second largest toy manufacturer in that country. Great Britain, France and Germany are also growing markets for the division's products.

Needlecraft	(millions of dollars)
77	\$47.8
76	\$36.6
75	\$32.3
74	\$26.5
73	\$28.5

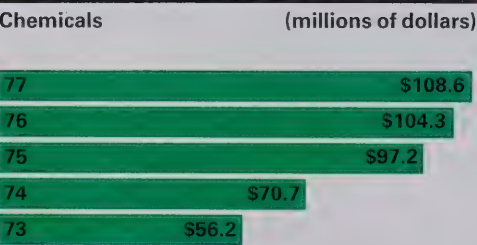
Sales of both yarn and needlecraft mail-order specialties increased substantially during the year. The new latch hook rug kits, introduced last year, were particularly well received. There was some expansion of order, warehousing and distribution facilities to support the division's growth. We expect this growth to continue, and remain very optimistic about the prospects of our kit and mail-order businesses.

Needlecraft

Sales of the Needlecraft Division have doubled in the last five years. In fiscal 1977, sales increased 31 percent over the prior year, and profitability was up by a significant percentage.

Chemicals Division

Serious problems in the Company's Chemicals Division, as well as steps taken in an effort to correct them, have been reported regularly to shareholders during the year. The division closed fiscal 1977 with an operating loss of \$8.8 million, compared with operating income of \$11.8 million the year before. Unit sales in fiscal 1977 were about 7 percent below last year although they were up 14 percent in the second half of that year, compared with the second half of fiscal 1976. Sales in dollars, because of the full-year effect of previously taken price increases, were up about 4 percent.



The Chemicals Division's problems are attributable to a combination of several factors. The volume decline over the past two years was caused by reduced levels of production in the foundry industry, which is the division's principal market for furfuryl alcohol; by customers working off large inventories of product built up during a prior period of furfural scarcity; and by a generally higher level of competition from other types of chemical binders and from other manufacturers of furfural and furfuryl alcohol.

The division's operating costs were up substantially because of expenses at our new Bayport, Texas, plant, which had serious operating problems and currently

is shut down to make modifications that were identified during production runs. Existing finished goods inventories are sufficient to support current demand, and completing these plant changes now is not expected to interfere with sales. The expenses involved will continue to directly affect earnings this year as modifications are completed to make Bayport operational later in 1978. Manufacturing and raw material costs overall were also a concern in fiscal 1977.

To address its problems, a number of changes in the Chemicals Division were made during the year. In January, the division began reporting directly to the President and Chief Operating Officer. A new division president and a new operations vice president made an intensive analysis of the total business and changed the directions of many programs. A number of other changes were also made:

- ☐ Substantial personnel reductions were effected.
- ☐ Product lines and research activities were re-examined, and projects of marginal interest, including an experimental raw material collection program, were eliminated.
- ☐ A small plant at Southall, England, was closed and production schedules at the Belle Glade, Florida, plant were changed to more closely coincide with the sugar cane grinding season, the by-product of which is used there to make furfural.
- ☐ Marketing personnel and strategies were strengthened.

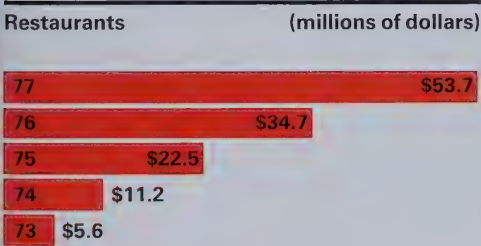
By fiscal year-end, the division had undergone significant change, and we wrote off approximately \$3 million in non-recurring expense. Even so, it will require time for new management and marketing approaches to take effect.

There are signs of encouragement, including the 14 percent year-to-year volume sales increase in the second half of fiscal 1977. Continuing favorable volume trends will be required, however, to utilize higher capacity that will exist when Bayport becomes fully operational.

Restaurants Division

Magic Pan Creperies continue as an attractive corporate growth thrust. In addition, two other specialty concepts — The Proud Popover and the recently acquired Engine House Pizza Co. — are being tested as potential additions to our restaurant business.

Fiscal 1977 sales increased 55 percent to \$53.7 million. Because of costs associated with the opening of 23 new restaurants, sluggish sales during the period of extreme winter weather, and higher payroll costs, operating income was off slightly from its year-ago level.



At June 30, there were 55 Magic Pan Creperies in the U.S. and four in Canada, each of which offers crepes and palacsintas in a warm, continental atmosphere for dining from luncheon through late-evening hours. Locations are in regional shopping malls and in downtown areas of large cities.

Burly Division

Burly continued as an important supplier of cookies sold by Girl Scout councils, as well as cookies and crackers sold regionally in grocery stores, and specialty biscuit products for ice cream producers. The division also handles sales of Quaker and Burly institutional products to the food service market nationally. Sales in fiscal 1977 increased 7 percent over the prior year. Profitability, while off moderately from the record level achieved last year, continued the good pattern of recent years.



**The Quaker Man
Trademark**

No one is surprised that the trademark of The Quaker Man has changed over the last hundred years. After all, a hundred years is a long time. The world changes, people change, and businesses and their symbols change, too, keeping themselves and their images contemporary and meaningful.

So it is with The Quaker Man.

In 1877, as one of the first trademarks registered for one of the original packaged consumer foods, he personified the purity and wholesomeness of the oatmeal product whose package bore his image.

That image was a simple one, in keeping with the times — quiet, understated, yet meaningful. No one in 1877 could be in doubt about what The Quaker Man stood for.

Later, beginning in the 1890's, the original square oatmeal package was printed in full color, and a more ornate label was designed — again in keeping with the times.



1877

Advertising in the early 1900's produced a rich variety of renditions of The Quaker Man, each appropriate to the message of the particular ad; some friendly and cheerful and smiling, others very purposeful, straightforward and serious.

This was the era of The Quaker Man who was friend of mothers, guardian of children, even keeper of the family's health! He was there when you needed him — he was "good for thee." Classic ads typifying this familial concern of The Quaker Man were appearing regularly in newspapers and magazines all across the United States, and they began to appear in other countries as well.



1907

The traditional round Quaker Oats tube calls to mind many fond childhood memories — and not just of wholesome breakfasts! This new cylindrical package, introduced in 1917, could become any one of a thousand handy things when it was empty. While the oatmeal continued to be the outstanding breakfast food it always had been, the container now provided everyone with myriad possibilities of future projects. More than a quarter-million of them became crystal set radios in 1921, for instance, not to mention all the pinhole cameras, toy boxes, drums, wagons, and other ingenious items dreamt up by creative minds and crafted by eager hands.



1917

A further-refined image that appeared in the mid-fifties radiates a rosy-cheeked warmth and friendliness of universal appeal. One might wonder what he's smiling about, but then, what would you expect from a man who's made so many people so happy over the years? His new image on the package proved he was still the good friend we always knew him to be.

In the mid-forties the cataclysm of World War II ended, and quickening trends in business and the nation's life-style, a faster pace, modernization, all dictated a newer, fresher image for The Quaker Man. This larger, head and shoulders version — more direct and recognizable — was then introduced.



1946



1957

Quaker today is a highly diversified company, with many respected brand names — Fisher-Price, Aunt Jemima, Ken-L Ration, Puss 'n Boots — and a host of others. This contemporary version of The Quaker Man was adopted in 1970 to enhance all elements of The Quaker Oats Company — despite lots of “professional” advice that a personalized symbol was obsolete for a diversified company. It was important to Quaker management to retain those personal qualities so long identified with The Quaker Man in our overall corporate identity, and we remain very pleased with that 1970 decision. As our corporate symbol, this stylized version of The Quaker Man well represents the inherent value and quality of the entire worldwide family of products and services that now bear the Quaker name.

The personal Quaker Man does continue to be shown on all Quaker brand consumer food products — including the 95 million tubes of Old Fashioned and Quick Quaker Oats sold in the U.S. in the past fiscal year.



1970

Year Ended June 30	1977	1976	1975
Net sales	\$1,551.3	\$1,473.0	\$1,389.0
Cost of goods sold	1,071.9	1,016.2	1,029.4
Gross profit	479.4	456.8	359.6
Selling, general and administrative expenses	330.8	304.0	256.8
Interest expense — net	12.9	13.4	26.4
Other expense (income)	.5	28.5	9.1
Income before income taxes and extraordinary charge	135.2	110.9	67.3
Provision for income taxes	67.6	57.8	36.3
Income before extraordinary charge	67.6	53.1	31.0
Extraordinary charge	—	—	—
Net income	67.6	53.1	31.0
Preferred and preference dividends	5.2	5.2	1.1
Net income available for common	\$ 62.4	\$ 47.9	\$ 29.9
Per common share: (A)			
Income before extraordinary charge	\$ 3.01	\$ 2.31	\$ 1.45
Extraordinary charge	—	—	—
Net income	\$ 3.01	\$ 2.31	\$ 1.45
Dividends declared	\$.92	\$.84	\$.80
Working capital	233.1	215.5	208.7
Net properties	406.7	373.6	358.2
Depreciation expense	33.5	33.0	29.6
Capital expenditures	72.0	62.7	71.9
Long-term debt	151.8	148.7	158.3
Shareholders' equity	471.3	431.8	400.7
Average number of common shares outstanding (000's)	20,762	20,711	20,699

(A) Adjusted for stock splits.

Millions of Dollars Except Share Data

1974	1973	1972	1971	1970	1969	1968
\$1,227.3	\$ 990.8	\$ 795.2	\$ 701.9	\$ 612.8	\$ 562.3	\$ 554.2
914.9	692.7	545.8	482.3	411.8	382.1	387.9
312.4	298.1	249.4	219.6	201.0	180.2	166.3
215.3	201.5	172.4	153.1	142.6	130.3	122.8
21.1	11.0	6.6	5.6	2.0	(.9)	.8
(.5)	.1	(.2)	.1	(.2)	.3	.6
76.5	85.5	70.6	60.8	56.6	50.5	42.1
36.6	43.4	35.0	29.7	27.9	24.5	20.6
39.9	42.1	35.6	31.1	28.7	26.0	21.5
—	—	—	5.9	—	1.1	—
39.9	42.1	35.6	25.2	28.7	24.9	21.5
.4	.4	.5	.5	.5	.5	.5
\$ 39.5	\$ 41.7	\$ 35.1	\$ 24.7	\$ 28.2	\$ 24.4	\$ 21.0
\$ 1.91	\$ 2.04	\$ 1.78	\$ 1.56	\$ 1.45	\$ 1.33	\$ 1.11
—	—	—	.30	—	.06	—
\$ 1.91	\$ 2.04	\$ 1.78	\$ 1.26	\$ 1.45	\$ 1.27	\$ 1.11
\$.76	\$.72	\$.68	\$.67	\$.63	\$.58	\$.53
184.5	156.1	131.0	110.6	91.5	81.2	84.0
319.3	272.1	243.9	200.4	181.3	142.6	129.1
24.8	20.1	15.1	12.3	9.0	8.9	8.4
68.2	52.6	42.1	39.8	31.8	28.0	23.6
171.4	123.8	131.5	96.4	68.8	18.9	21.4
338.4	312.8	259.6	232.0	217.7	197.2	184.6
20,675	20,466	19,760	19,590	19,400	19,171	18,817

basis, gross profit margins for the last two years remained relatively stable: 30.9 percent in fiscal 1977 and 31 percent in fiscal 1976. Costs of energy, transportation, salaries and employee benefits increased in both years, and depreciation expenses and maintenance and repair expenses also increased as a result of recent capital additions and a higher level of business activity, respectively. In addition, due to serious operating problems, fiscal 1977 production costs at the new Bayport, Texas, chemical plant were approximately \$7 million higher than expected. The plant is shut down until later in the year, while necessary modifications are made.

Sales

Sales in fiscal 1977 were a record high \$1.55 billion or 5.3 percent higher than fiscal 1976. Excluding fiscal 1976 sales of the Marx operations that were sold in April, 1976, sales in continuing businesses exceeded last year by \$121.1 million, or 8.5 percent, with all areas contributing to the improvement. Approximately two-thirds of this increase resulted from unit volume gains and favorable product mix. The overall increase was achieved despite a 7 percent volume decline in the Chemicals Division. Fiscal 1976 sales were 6 percent ahead of the \$1.39 billion in fiscal 1975, due primarily to the full-year impact of price increases instituted in fiscal 1975 and the effect of consolidating Quaker France, a wholly owned subsidiary that was previously a joint venture.

Cost of Goods Sold

Cost of goods sold in fiscal 1977 was \$1.07 billion, or 5.5 percent higher than fiscal 1976, primarily because of increased sales volume. In fiscal 1976, cost of goods sold decreased by \$13.2 million compared to fiscal 1975 because principal raw materials were purchased at significantly lower costs than those incurred in the prior year. On an overall

Selling, General and Administrative

Selling, general and administrative expenses were \$330.8 million in fiscal 1977 versus \$304 million in fiscal 1976, an 8.8 percent increase. The comparable increase in fiscal 1976 over fiscal 1975 was \$47.2 million or 18.4 percent. Of the fiscal 1977 increase, \$14.7 million or 54.9 percent was due to an increase in consolidated advertising and merchandising expenses necessary to support new product introductions, maintain or improve market shares of existing product lines and expand into new market areas. Advertising and merchandising expenditures in continuing businesses increased 16.7 percent in fiscal 1977. In fiscal 1976, advertising and merchandising expenditures increased \$25.1 million or 22.9 percent. Research and development expenses of \$19.3 million

in fiscal 1977 were slightly ahead of a year ago. Fiscal 1976 R&D expenses increased 12.4 percent or \$2.1 million over fiscal 1975.

Research & Development (millions of dollars)

77	\$19.3
76	\$19.0
75	\$16.9
74	\$15.4
73	\$14.0

Net Interest Expense

Net interest expense declined 3.9 percent in fiscal 1977 to \$12.9 million, primarily as a result of increased interest income on short-term investments. In fiscal 1976, net interest expense declined 49.2 percent from fiscal 1975, reflecting lower working capital requirements, lower interest rates and the full-year effect of the May, 1975, preference stock offering.

Other Expenses

Other expenses in fiscal 1977 include charges of \$2.7 million associated with the Chemicals Division's termination of an experimental raw material collection program in the United States and the closing of a small furfuryl alcohol manufacturing plant in the United Kingdom. The major other expense item in fiscal 1976 was the pre-tax write-off of \$23.2 million in connection with the April, 1976, sale of the Marx Toys operations.

Tax Rate

Tax rate in fiscal 1977 is 50 percent, compared with 52.1 percent in the prior year and 53.9 percent in fiscal 1975. The change in the effective tax rates is

primarily due to a change in the mix of domestic and international earnings.

Net Income

Net income increased 27.3 percent in fiscal 1977 to \$67.6 million. In fiscal 1976, net income was \$53.1 million, up 71.1 percent from the prior year, when results were adversely affected by an unusually high inflation rate and commodity costs. Fiscal 1977 results include a significant operating loss in the Chemicals Division and a \$1.2 million credit resulting from the adoption of the provisions of Financial Accounting Standards Board Statement No. 8. Fiscal 1976 included a 57 cents per share write-off in connection with the sale of Marx Toys in April, 1976 and operating losses of that business prior to its sale. In addition, in fiscal 1976 the Company changed the method of pricing its domestic Chemicals Division inventories from average annual costs to LIFO, the effect of which was to reduce net income by 3 cents a share.

Capital Expenditures

Capital expenditures during fiscal 1977 were \$72 million, up 14.8 percent over last year. Spending was broadly dispersed throughout all areas of the business. Fiscal 1978 capital expenditures are expected to be above fiscal 1977, again with spending to be

dispersed broadly throughout the company.

Capital Expenditures	(millions of dollars)
77	\$72.0
76	\$62.7
75	\$71.9
74	\$68.2
73	\$52.6

Dividends

For the tenth consecutive year, the quarterly dividend on common shares was increased. This increase — from 21 cents to 23 cents — was effective with the October, 1976, payment.

Financing

The Company called for redemption all outstanding shares of its \$3 Cumulative Convertible Preferred Stock at \$58 a share plus accrued dividends to the June 13, 1977, redemption date. The shares were convertible into 2.475 shares of common stock up to June 3, 1977. Of the total, 64,539 shares (46 percent) were converted to common; the balance was redeemed for cash of about \$4.5 million.

The Company's \$75 million revolving credit agreement was increased to \$135 million, and the maturity was extended to June 30, 1982. The Company also has domestic bank lines of credit totaling \$65 million. None of the \$200 million in bank facilities is currently in use. Quaker's non-U.S. subsidiaries have credit facilities totaling \$84 million. At June 30, 1977, \$43 million of these facilities were not being used.

Millions of Dollars Except Share Data

Year Ended June 30

	First Quarter (Sept. 30)	Second Quarter (Dec. 31)	Third Quarter (Mar. 31)	Fourth Quarter (June 30)	Full Fiscal Year
1977					
Net sales	\$394.1	\$397.1	\$383.6	\$376.5	\$1,551.3
Cost of goods sold	268.1	273.6	260.3	269.9	1,071.9
Gross profit	\$126.0	\$123.5	\$123.3	\$106.6	\$ 479.4
Net income	\$ 25.0	\$ 16.1	\$ 15.9	\$ 10.6	\$ 67.6
Preferred and preference dividends	1.3	1.3	1.3	1.3	5.2
Net income available for common	\$ 23.7	\$ 14.8	\$ 14.6	\$ 9.3	\$ 62.4
Income per common share	1.14	.72	.70	.45	3.01
Cash dividends declared per common share	.23	.23	.23	.23	.92
Market price range per common share	27 ³ / ₄ — 22 ¹ / ₄	26 ¹ / ₈ — 20 ⁷ / ₈	26 ⁵ / ₈ — 21 ⁵ / ₈	24 ¹ / ₈ — 21 ³ / ₈	27 ³ / ₄ — 20 ⁷ / ₈
1976					
Net sales	\$385.7	\$394.8	\$356.3	\$336.2	\$1,473.0
Cost of goods sold	263.8	271.6	241.2	239.6	1,016.2
Gross profit	\$121.9	\$123.2	\$115.1	\$ 96.6	\$ 456.8
Net income	\$ 22.0	\$ 4.9(A)	\$ 15.9	\$ 10.3	\$ 53.1(A)
Preferred and preference dividends	1.3	1.3	1.3	1.3	5.2
Net income available for common	\$ 20.7	\$ 3.6	\$ 14.6	\$ 9.0	\$ 47.9
Income per common share	1.00	.18	.70	.43	2.31
Cash dividends declared per common share	.21	.21	.21	.21	.84
Market price range per common share	20 ¹ / ₈ — 15	27 ¹ / ₄ — 16 ⁷ / ₈	28 ³ / ₈ — 22 ³ / ₄	27 ³ / ₈ — 22 ³ / ₄	28 ³ / ₈ — 15

Pro Forma Data:

Pro forma amounts for 1976, assuming retroactive application of the July 1, 1976, changes in the method of pricing selected interim inventories and accounting for certain interim advertising and merchandising expenses, are as follows (see notes to the consolidated financial statements for further details):

Net income	\$ 24.3	\$ 5.1(A)	\$ 14.3	\$ 9.4	\$ 53.1(A)
Income per common share	\$ 1.11	\$.18	\$.63	\$.39	\$ 2.31

(A) After a net of tax provision of \$11.9 million, equivalent to 57 cents a share, to write-down Marx Toys operations sold on April 15, 1976.

				Millions of Dollars	
Year Ended June 30	1977	1976	1975	1974	1973
U.S. Grocery Products Area	\$ 713.9	\$ 680.4	\$ 666.1	\$ 569.1	\$ 480.9
	87.7	84.2	46.6	45.1	48.3
International Grocery Products Area*	356.3	336.0	293.5	256.8	181.1
	23.2	22.4	15.2	17.2	9.6
Diversified Businesses Area					
Toys and Crafts	243.8	204.7	179.2	192.5	148.3
	35.0	29.0	16.7	24.4	25.5
Chemicals	108.6	104.3	97.2	70.7	56.2
	(8.8)	11.8	22.1	8.5	5.8
Institutional Foods and Restaurants	128.7	104.8	88.7	60.6	47.9
	11.0	12.3	6.3	1.4	.9
Total Diversified Businesses Area	481.1	413.8	365.1	323.8	252.4
	37.2	53.1	45.1	34.3	32.2
Total Continuing Businesses	1,551.3	1,430.2	1,324.7	1,149.7	914.4
	148.1	159.7	106.9	96.6	90.1
Marx operations sold	—	42.8	64.3	77.6	76.4
	—	(35.4)**	(13.2)	1.0	6.4
Total Sales	1,551.3	1,473.0	1,389.0	1,227.3	990.8
Total Operating Income	148.1	124.3	93.7	97.6	96.5
Less interest expense — net	12.9	13.4	26.4	21.1	11.0
Income before income taxes	\$ 135.2	\$ 110.9	\$ 67.3	\$ 76.5	\$ 85.5

Sales figures — black ink

Operating income figures — brown ink

*Results of Canadian grocery products operations are included in the International Grocery Products Area for all years presented.

**Includes a \$23.2 million pre-tax write-off provision resulting from the April, 1976, sale of the U.S., Canadian and Hong Kong operations of the Marx Toys Division (equivalent to \$.57 per share).

The Quaker Oats Company and Subsidiaries

Thousands of Dollars

Year Ended June 30	1977	1976
Net Sales	\$ 1,551,348	\$ 1,473,052
Cost of goods sold	1,071,953	1,016,220
Gross profit	479,395	456,832
Selling, general and administrative expenses	330,822	304,037
Interest expense — net	12,909	13,426
Other expense	475	28,483
Income Before Income Taxes	135,189	110,886
Provision for income taxes	67,615	57,793
Net Income	67,574	53,093
Preferred and preference dividends	5,146	5,206
Net Income Available for Common	\$ 62,428	\$ 47,887
Per Common Share:		
Net income	\$3.01	\$2.31
Dividends declared	\$.92	\$.84
Average Common Shares Outstanding	20,762,440	20,711,092

See accompanying notes to consolidated financial statements.

Assets

	Thousands of Dollars	
June 30	1977	1976
Current Assets:		
Cash and marketable securities	\$ 44,865	\$ 77,869
Receivables (less allowances of \$7,452 and \$6,598, respectively)	174,261	139,184
Inventories	228,772	198,206
Prepaid expenses	11,763	9,562
Current assets	459,661	424,821
Other Receivables and Investments	13,925	13,633
Property, Plant and Equipment, at cost:		
Land	8,657	8,801
Buildings and improvements	165,241	148,759
Machinery and equipment	394,745	358,800
	568,643	516,360
Less accumulated depreciation	161,938	142,772
Properties — net	406,705	373,588
Intangible Assets:		
Excess of cost over net assets of acquired businesses, less amortization	41,408	40,188
Patents, trademarks and designs, less amortization	2,554	2,717
	\$924,253	\$854,947

See accompanying notes to consolidated financial statements.

Liabilities and Shareholders' Equity

Thousands of Dollars

June 30	1977	1976
Current Liabilities:		
Short-term debt	\$ 62,130	\$ 46,240
Current portion of long-term debt	2,363	2,030
Accounts payable and accrued expenses	138,901	122,246
Income taxes payable	17,118	33,179
Dividends payable	6,009	5,655
Current liabilities	226,521	209,350
Long-term Debt	151,802	148,668
Other Liabilities	13,427	15,579
Deferred Income Taxes	61,154	49,599
Shareholders' Equity:		
Preferred stock, \$50 par value, \$3 cumulative convertible, authorized 147,553 shares; issued 141,821 shares in 1976	—	7,091
Preference stock, without par value, \$100 stated value, \$9.56 cumulative, authorized 1,500,000 shares; issued 500,000 shares	50,000	50,000
Common stock, \$5 par value, authorized 35,000,000 shares; issued 20,997,349 and 20,979,469 shares, respectively	104,987	104,897
Additional paid-in capital	23,004	23,193
Reinvested earnings	294,881	252,197
	472,872	437,378
Less treasury common stock, at cost	1,523	5,627
Shareholders' equity	471,349	431,751
	\$924,253	\$854,947

	Thousands of Dollars					
	Preferred Stock	Preference Stock	Common Stock	Additional Paid-In Capital	Reinvested Earnings	Treasury Common Stock
Balance at June 30, 1975	\$7,105	\$50,000	\$104,745	\$22,814	\$221,710	\$5,627
Net income					53,093	
Dividends on —						
Preferred stock					(426)	
Preference stock					(4,780)	
Common stock					(17,400)	
Common stock issued for stock options and conversion of preferred stock	(14)		152	379		
Balance at June 30, 1976	7,091	50,000	104,897	23,193	252,197	5,627
Net income					67,574	
Dividends on —						
Preferred stock					(366)	
Preference stock					(4,780)	
Common stock					(19,130)	
Common stock issued for stock options, stock awards and conversion of preferred stock	(3,252)		90	(189)		(4,104)
Redemption of preferred stock	(3,839)				(614)	
Balance at June 30, 1977	—	\$50,000	\$104,987	\$23,004	\$294,881	\$1,523

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

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The Quaker Oats Company and Subsidiaries

Thousands of Dollars

Year Ended June 30**1977****1976****Sources of Funds:**

Operations

Net income	\$ 67,574	\$ 53,093
Depreciation and amortization	35,256	34,832
Deferred income taxes	11,555	2,632
Loss on sale of Marx non-current assets	—	9,700
Total from operations	114,385	100,257
Increase in accounts payable and accrued expenses	16,655	14,233
Increase in short-term debt	15,890	17,712
Proceeds from new long-term debt	6,917	16,050
Sales of properties—other	5,823	2,510
Proceeds from sale of Marx non-current assets	—	6,646
Total funds provided	159,670	157,408

Uses of Funds:

Additions to properties	72,049	62,709
Increase (decrease) in receivables	35,077	(5,167)
Increase in inventories	30,566	9,503
Cash dividends	24,276	22,606
Decrease (increase) in income taxes payable	16,061	(26,364)
Redemption of preferred stock	4,453	—
Decrease in long-term debt	3,783	25,665
Excess of cost over net current assets of acquired businesses	3,083	5,856
Decrease (increase) in other long-term liabilities	2,152	(5,472)
Increase in other receivables and investments	292	8,248
Other—decrease (increase)—net	882	(438)
Total funds used	192,674	97,146
Net (decrease) increase in cash and marketable securities	\$ (33,004)	\$ 60,262

See accompanying notes to consolidated financial statements.

The Quaker Oats Company and Subsidiaries

Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include The Quaker Oats Company and all subsidiaries. All significant intercompany transactions have been eliminated.

Currency Translation

In accordance with the provisions of Financial Accounting Standards Board Statement No. 8, the Company changed its method of translating non-U.S. currency transactions and financial statements effective July 1, 1976. The principal item affected by this change is inventories, which were previously translated at current exchange rates.

Under this current method, all translation gains and losses, both realized and unrealized, are recognized in income currently. Prior to the change, unrealized gains, net of previously recorded losses, were deferred; the cumulative reserve for deferred translation of \$1.2 million was credited to income in 1977. Prior years' operating results have not been restated to retroactively reflect this change because the effect is not material.

Intangibles

Excess of cost over net assets of acquired businesses, including \$27,079,000 related to acquisitions prior to November 1, 1970 (principally Fisher-Price Toys, Inc.), represents the amounts paid in excess of the fair values of the net assets of such businesses, less amortization. Such costs are considered to represent continuing values and are adjusted if reduction of the continuing values of underlying businesses is indicated. All such costs resulting from acquisitions after October 31, 1970, are amortized over periods not in excess of 20 years. Amortization for 1977 and 1976 was \$1,455,000 and \$1,345,000, respectively.

Costs incurred in acquiring patents, trademarks and designs are amortized on a straight-line basis over their estimated useful lives. Amortization for 1977 and 1976 was \$284,000 and \$523,000, respectively.

Inventories

Inventories are priced at the lower of cost (principally first-in, first-out for restaurants, crafts, and international toys; last-in, first-out for domestic chemicals and toys; and average quarterly cost for other inventories) or market. At June 30, 1977, 65 percent of the inventories are priced at average quarterly cost, 14 percent at FIFO, and 21 percent at LIFO. In the fourth quarter of 1977, the Company changed its method of pricing domestic toy inventories from first-in, first-out to last-in, first-out (LIFO). This change, which was made retroactive to the beginning of the fiscal year, did not materially affect net income. Inventories used in computing cost of goods sold are summarized on the following page.

Thousands of Dollars

	1977	1976	1975
Finished goods	\$143,952	\$116,948	\$101,222
Grain and materials	70,765	70,309	74,767
Supplies	14,055	10,949	12,714
	\$228,772	\$198,206	\$188,703

Effective July 1, 1976, the Company changed its method of pricing U.S. and International Grocery Products, international chemical and institutional food inventories from average annual to average quarterly cost. The change, which has no material effect on annual net income, was made to make the basis of reporting interim results more comparable with that of reporting full-year results. In 1976, the Company changed to the LIFO method of pricing domestic chemical inventories; the effect of the change was to reduce net income by 3 cents a share. At June 30, 1976, approximately 68 percent of the inventories were priced using average annual cost, 27 percent using FIFO and 5 percent using LIFO.

Depreciation and Properties

Depreciation is computed using the straight-line method, which is designed to recover the cost of the properties over their estimated useful lives. Depreciation expense for 1977 and 1976 was \$33,517,000 and \$32,964,000, respectively. The rates used were:

Buildings and improvements	2% to 10%
Machinery and equipment	5% to 25%
Automobiles and trucks	20% to 33%
Miscellaneous equipment, office furniture and fixtures	10% to 25%

The composite method is used for depreciation, and only abnormal gains and losses on sales or abandonments of property are included in current income.

Maintenance and repairs, which are charged to expense as incurred, were \$41,853,000 in 1977, and \$34,989,000 in 1976. Significant replacements and betterments are capitalized.

Research and Development

Research and development expenditures are expensed as incurred. During 1977 and 1976, these expenses were \$19,332,000 and \$18,964,000, respectively.

Advertising

Advertising expenditures are charged to expense as incurred. Effective July 1, 1976, the Company changed the method of recording certain interim advertising and merchandising expenditures. Certain of these expenses that previously had been charged to interim periods in proportion to projected annual sales are now being expensed as incurred. This change had no effect on annual net income. Advertising media and production costs were \$60,335,000 in 1977 and \$57,800,000 in 1976.

Income Taxes

Deferred income taxes are provided on timing differences and result primarily from the use of accelerated depreciation methods for tax purposes.

Investment tax credits are deferred and amortized over the estimated useful lives of the related assets. These deferred credits, which are included in the liability for deferred income taxes, amounted to \$12,974,000 and \$11,310,000 at June 30, 1977 and 1976, respectively.

Except for minor amounts, no federal income taxes have been provided on the undistributed earnings of non-U.S. subsidiaries, since they are expected to be permanently invested in those countries.

Pension Plans

The Company and its subsidiaries have various plans covering a majority of the employees. The provision for pensions charged to income each year is sufficient to cover normal costs of the plans and, for principal plans, amortization of prior-service costs over 40 years. Pension costs are funded currently, and the pension funds are in excess of the actuarially computed value of vested benefits. Pension expense was \$10,535,000 in 1977 and \$9,389,000 in 1976.

Net Income Per Common Share

Net income per common share is based on the weighted average number of common shares outstanding. Dilution, which would result from the exercise of stock options outstanding, is not significant.

Non-U.S. Operations

Summarized financial information for non-U.S. operations appears on the following page.

In 1977, the net exchange and translation gain amounted to \$3,699,000, including a \$1,228,000 credit related to the adoption, effective July 1, 1976, of the provisions of FASB Statement No. 8. As required by this statement, inventories included in the computation of cost of goods sold are translated at exchange rates in effect at the time of acquisition rather than the previous method of using current average exchange rates. The effect of this change in 1977 was to charge cost of goods sold with approximately \$7 million, which under the previous accounting rules would have been recorded as a translation loss.

In 1976, the net exchange and translation loss amounted to \$850,000 and was charged to income. The reserve for unrealized gains, included in other liabilities, decreased by \$74,000 during the year, and at June 30, 1976, was \$1,228,000.

Thousands of Dollars

Non-U.S. Operations	1977	1976
Assets:		
Current assets	\$160,209	\$134,877
Properties — net	71,184	64,038
Other assets	18,242	19,358
	\$249,635	\$218,273
Less:		
Current liabilities	\$ 94,464	\$ 72,371
Other liabilities	17,417	18,441
	\$111,881	\$ 90,812
Net assets	\$137,754	\$127,461
Net assets:		
Canada	\$ 25,793	\$ 23,495
Europe	68,605	62,450
Latin America and Pacific	43,356	41,516
	\$137,754	\$127,461
Net sales:		
Canada	\$108,969	\$ 98,209
Europe	222,652	201,856
Latin America and Pacific	126,199	122,648
	\$457,820	\$422,713
Operating income:		
Canada	\$ 5,872	\$ 3,119
Europe	19,822	19,470
Latin America and Pacific	13,097	10,957
	\$ 38,791	\$ 33,546
Reinvested earnings	\$ 78,796	\$ 67,805

	Thousands of Dollars	
Cash and Marketable Securities	1977	1976
Cash	\$ 3,033	\$ 1,363
Time deposits and certificates of deposit	38,784	66,173
Marketable securities*	3,048	10,333
	\$ 44,865	\$ 77,869

*Marketable securities are stated at cost, which approximates market.

	Thousands of Dollars	
Accounts Payable and Accrued Expenses	1977	1976
Accounts payable	\$ 64,211	\$ 59,328
Other taxes, not based on income	8,227	8,418
Payrolls, pensions and bonuses	34,600	28,578
Interest	3,226	2,711
Consumer couponing	15,794	13,477
Miscellaneous	12,843	9,734
	\$138,901	\$122,246

	Thousands of Dollars	
Short-Term Debt	1977	1976
Notes payable to banks —		
Non-U.S. subsidiaries	\$ 41,028	\$ 24,833
Commercial paper —		
Dealer placed	—	—
Master trust notes	21,102	21,407
	\$ 62,130	\$ 46,240

Weighted average interest rates on debt outstanding at end of year —		
Notes payable to banks — non-U.S.	14.1%	12.5%
Commercial paper	5.5%	5.9%
Weighted average interest rates on debt outstanding during the year —		
Notes payable to banks — non-U.S. (computed on month-end balances)	16.2%	11.5%
Commercial paper (computed on daily balances)	5.4%	6.2%
Weighted average amount of debt outstanding during the year	\$ 54,434	\$ 54,816
Maximum month-end balance during the year	\$ 64,575	\$ 74,389

Credit Facilities

The Company has a revolving credit agreement, none of which has been utilized, that provides for \$135,000,000 in either domestic or Eurodollar borrowings at the Company's option and expires June 30, 1982. The agreement requires an annual commitment fee of $\frac{1}{2}$ of 1% for any unused portion.

The Company, in addition to the unused \$135,000,000 revolving credit agreement, has approximately \$65,000,000 available in unused domestic bank lines of credit to meet general corporate purposes. The Company's non-U.S. subsidiaries had additional unused lines of credit of approximately \$43,000,000 at June 30, 1977.

The Company has informal arrangements with certain banks to maintain balances in compensation for credit facilities. These compensating balance arrangements, which approximated \$5,400,000 at June 30, 1977, are based on the average annual amount on deposit according to bank records and impose no restrictions upon the Company's withdrawal of funds. At certain other banks, compensation for credit facilities is on a fee basis.

	Thousands of Dollars	
Long-Term Debt	1977	1976
6% industrial revenue bonds due from 2002 through 2007	\$ 4,600	\$ —
Solid waste disposal revenue bonds —		
5½ % bonds due 1991	3,000	3,000
6½ % bonds, \$1,000 due annually from 2000 through 2002 and increasing amounts from 2003 through 2006	12,000	12,000
7.70% sinking fund debentures, \$1,800 due annually from 1978 through 2001 (net of \$1,375 held at June 30, 1977)	46,825	50,000
7.80% notes, \$3,700 due annually from 1980 through 1989 and \$3,800 due annually from 1990 through 1994	56,000	56,000
8¾ % note, \$1,665 due annually from 1980 through 1994	25,000	25,000
Capitalized lease obligations	1,797	1,729
Obligations of non-U.S. subsidiaries	4,943	2,969
	154,165	150,698
Less: Current portion	2,363	2,030
	\$151,802	\$148,668

Aggregate required payments for 1978 through 1982 on long-term debt are: \$2,363,000, \$4,196,000, \$7,129,000, \$7,507,000, and \$7,500,000, respectively. The notes and debentures may be called at the option of the Company at a premium and subject to restrictions as specified in the related agreements.

Under the most restrictive terms of the various loan agreements in effect at June 30, 1977, \$176,025,000 of reinvested earnings is not available for payment of cash dividends and/or certain other distributions to preference and common shareholders, and minimum working capital of \$175,000,000 must be maintained.

Capital Stock

Changes in shares of capital stock follow:

	Preferred Stock	Preference Stock	Common Stock	Treasury Common Stock
Balance at June 30, 1975	142,104	500,000	20,948,922	249,914
Common stock issued for stock options and conversions of preferred stock	(283)		30,547	
Balance at June 30, 1976	141,821	500,000	20,979,469	249,914
Common stock issued for stock options, stock awards and conversions of preferred stock	(65,039)		17,880	(182,249)
Preferred stock redemption	(76,782)			
Balance at June 30, 1977	—	500,000	20,997,349	67,665

In June, 1977, the Company redeemed the outstanding \$3 cumulative preferred shares at \$58 per share plus accrued dividends. Prior to redemption, each of these shares had been convertible at the holder's option into 2.475 shares of common stock.

The \$9.56 cumulative preference stock is redeemable, at the option of the Company, in whole or in part at prices decreasing from \$109.56 per share currently to \$100 after July 19, 2000, except that until July 20, 1980, such redemption cannot be made from the proceeds of indebtedness or the issuance of stock other than common stock having a cost of less than 9.56%. Each year, commencing on July 20, 1981, the Company must make payments to a sinking fund in an amount adequate to retire a minimum of 20,000 shares (maximum 40,000 shares) of preference stock at \$100 per share, plus accrued dividends.

Employees Stock Option and Award Plans

On November 10, 1976, the Company's Stock Option Plan was amended to increase the number of shares that can be issued to 1,500,000, either from unissued or treasury shares, and also to provide for the granting of stock appreciation rights. Eligible officers and other managerial employees may be granted options for the purchase of common stock at not less than the fair market value at the date of grant. Options are generally exercisable after one or more years and expire no later than ten years from date of grant. No options may be granted after September 10, 1981.

Changes in stock options outstanding are summarized as follows:

	Thousands of Dollars		
	Shares	Option Price Per Share	Total
Outstanding at June 30, 1975	950,223	\$13.13—42.82	\$ 24,552
Granted	10,985	25.19	277
Exercised	(29,849)	13.13—15.06	(447)
Expired or terminated	(167,521)	15.06—42.82	(4,959)
Outstanding at June 30, 1976	763,838	13.13—42.82	19,423
Granted	216,335	23.44—25.25	5,072
Exercised	(35,567)	15.06	(536)
Expired or terminated	(174,504)	15.06—42.82	(5,393)
Outstanding at June 30, 1977	770,102	\$13.13—42.82	\$ 18,566

The fair market value per share at the date on which options were exercised ranged from \$21.19 to \$27.56 in 1977 and from \$22.94 to \$28.06 in 1976, and the total market values of those options at the same dates were \$846,000 and \$759,000, respectively. During 1977, options to purchase 169,930 shares at prices from \$13.13 to \$31.00 became exercisable at an aggregate option price of \$3,491,000. The market value per share at the exercisable date ranged from \$23.44 to \$25.88, and aggregated \$4,013,000. At June 30, 1977, 655,717 shares were available for the granting of additional options. During 1976, options to purchase 170,864 shares at prices from \$13.13 to \$31.00 became exercisable at an aggregate option price of \$3,373,000. The market value per share at the exercisable date ranged from \$24.00 to \$25.94, and aggregated \$4,171,000. At June 30, 1976, 97,548 shares were available for the granting of additional options.

In 1977, an Employee Stock Award Plan was approved by the shareholders. The plan provides that all domestic and certain non-U.S. employees will receive five shares of common stock if they complete five years of service prior to January 1, 1982. The maximum number of shares that may be awarded is 60,000.

Management Incentive Plans

The principal management incentive plan provides that an annual bonus be paid out of earnings to certain managerial employees, as determined by a committee of directors of the Company who do not participate in the plan. Other plans are in effect in certain non-U.S. and domestic subsidiaries; the provision for these other plans amounted to approximately 30 percent of the consolidated provision for 1977. The provision for all plans was \$3,639,000 in 1977 and \$3,650,000 in 1976.

	Thousands of Dollars	
Interest Expense — Net	1977	1976
Interest expense on long-term debt	\$11,773	\$12,092
Interest expense — other	6,584	5,186
Interest income on marketable securities, including time deposits and certificates of deposit	(4,180)	(2,719)
Interest income — other	(1,268)	(1,133)
	\$12,909	\$13,426

	Thousands of Dollars	
Other Expense	1977	1976
Commitment fees for credit facilities	\$ 466	\$ 432
Net exchange and translation (gain) loss	(3,699)	850
Toy division charges	—	23,200
Other — net	3,708	4,001
	\$ 475	\$28,483

The toy division charges relate to the April, 1976, sale of substantially all of the assets of the U.S., Canadian and Hong Kong operations of the Marx Toys Division. After related income tax benefits of \$11,300,000, net income was reduced by \$11,900,000, equivalent to \$.57 per common share.

	Thousands of Dollars	
Provision for Income Taxes	1977	1976
Currently payable —		
Federal	\$36,430	\$33,724
State	5,609	4,969
Non-U.S.	14,021	16,468
Deferred — (primarily federal taxes related to depreciation and, in 1976, effect of the Marx sale)	9,891	(2,200)
Deferred investment tax credit — net	1,664	4,832
	\$67,615	\$57,793

The provision for income taxes varied from the "expected" tax expense computed at 48% of income before income taxes, as follows:

	Thousands of Dollars			
	1977		1976	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Computed "expected" tax expense	\$64,891	48.0%	\$53,225	48.0%
State and local income taxes, net of federal income tax benefit	3,367	2.5	2,806	2.5
Non-U.S. tax rate differential	(689)	(.5)	1,965	1.8
Miscellaneous items — net	46	—	(203)	(.2)
Actual tax expense	\$67,615	50.0%	\$57,793	52.1%

The change in the mix of domestic and international earnings was the principal reason for the lower effective income tax rate in 1977 compared to 1976.

	Thousands of Dollars	
	1977	1976
Provision for Other Taxes (not based on income)		
Real estate and personal property	\$ 5,107	\$ 5,053
Payroll	22,071	14,760
Other	6,469	2,146
	\$33,647	\$21,959

Leases

Certain equipment and operating properties are rented under non-cancellable leases that expire at various dates through 2062. Some of these leases are non-capitalized financing leases as defined by the Securities and Exchange Commission. The present value of non-capitalized financing leases and its effect on net income are not significant. Subleases are not significant.

Total rental expense for 1977 and 1976 was:

	Thousands of Dollars	
	1977	1976
Non-capitalized financing leases	\$ 2,795	\$ 2,394
Other (including restaurant rentals of \$2,627, in 1977 and \$1,534, in 1976, of which \$715 and \$525 represented contingent rentals based on sales in 1977 and 1976, respectively)	13,957	12,932
	\$16,752	\$15,326

Future minimum annual rentals on non-cancellable leases in effect at June 30, 1977 are:

Thousands of Dollars

Fiscal Years	Financing (Primarily Office Equipment)	Operating		Total
		Buildings	Distribution Equipment and Other	
1978	\$ 2,217	\$ 6,772	\$ 954	\$ 9,943
1979	237	6,173	693	7,103
1980	49	4,947	329	5,325
1981	27	5,953	315	6,295
1982	22	5,669	128	5,819
1983-1987	124	22,963	180	23,267
1988-1992	114	743	180	1,037
1993-1997	143	325	180	648
Thereafter	1,772	—	1,518	3,290

The Company has adopted, effective January 1, 1977, the criteria for recording new leases as required by Financial Accounting Standards Board Statement No. 13. The provisions of this Statement have no material effect on the financial statements.

Millions of Dollars, Except Per Share

Quarterly Results of Operations (Unaudited)	Net Sales	Gross Profit	Net Income	Net Income Per Common Share
Fiscal 1977				
First Quarter	\$ 394.1	\$126.0	\$25.0	\$1.14
Second Quarter	397.1	123.5	16.1	.72
Third Quarter	383.6	123.3	15.9	.70
Fourth Quarter	376.5	106.6	10.6	.45
Full Year	\$1,551.3	\$479.4	\$67.6	\$3.01

Replacement Cost Data (Unaudited)

As required by Rule 3-17 of Regulation S-X of the Securities and Exchange Commission, the Company's Annual Report on Form 10-K contains information disclosing the estimated replacement cost of inventories; the cost of sales on the basis of the replacement cost of goods at the time of sale; gross and depreciated replacement cost of productive capacity; and depreciation expense on a replacement cost basis. Shareholders who wish to obtain such information should request a copy of the Form 10-K in accordance with the instructions on page 48.

Litigation

The Federal Trade Commission, in a complaint filed on April 26, 1972, alleged that the ready-to-eat cereal industry is concentrated in and controlled by four industry members, including the Company, which members have diminished competition by avoiding price competition and by raising entry barriers through various practices such as brand proliferation, excessive and misleading advertising, exclusionary shelf-space programs, and acquisitions. The Federal Trade Commission has proposed an order requiring the other three respondents (but not the Company) to divest certain properties and license certain trademarks to other manufacturers, and prohibiting all of the respondents (including the Company) from acquiring other cereal manufacturers for twenty years and from providing shelf-space programs to customers. The Company has denied the charges and trial is currently in progress. In the opinion of the Company's Senior Vice President — Law, the Company has meritorious defenses to the allegations in the complaint. The Company believes that the litigation will have no material adverse effect on its business.

Auditors' Report

To the Shareholders of The Quaker Oats Company:

We have examined the consolidated balance sheet of The Quaker Oats Company (a New Jersey corporation) and Subsidiaries as of June 30, 1976, and June 30, 1977, and the related consolidated statements of income, shareholders' equity and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of The Quaker Oats Company and Subsidiaries as of June 30, 1976, and June 30, 1977, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

Arthur Andersen & Co.

Chicago, Illinois
August 18, 1977

Members of the Board of Directors

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Chief Executive Officer
Illinois Tool Works, Inc.
(Diversified Products)
Chicago, Illinois

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Chief Executive Officer
Fleming Companies, Inc.
(Wholesale and Retail Foods)
Oklahoma City, Oklahoma

***Augustin S. Hart, Jr.**

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President
Corning Glass Works
(Diversified Products)
Corning, New York

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Chief Operating Officer

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Educational Affairs and
Professor of Marketing
Harvard Business School
Boston, Massachusetts

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President, Scribner & Co.
(Real Estate Brokerage,
Management & Appraisals)
Chicago, Illinois

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Senior Vice President
Finance

***Robert D. Stuart, Jr.**

Chairman and
Chief Executive Officer

***Robert N. Thurston**

Senior Vice President
Corporate Affairs

Arthur M. Wood

Chairman and
Chief Executive Officer
Sears, Roebuck and Co.
(Retail Merchandising and
Insurance)
Chicago, Illinois

*Member of the Executive
Committee

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Messrs. Meads and Salmon

Compensation and Stock Option Committee

Mr. Scribner, Chairman;
Mrs. Michelson,
Messrs. Cathcart and Harrison

Public Responsibility Committee

Mr. Cathcart, Chairman;
Mrs. Michelson, Dr. MacAvoy

Senior Officers

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Chairman and
Chief Executive Officer

Kenneth Mason
President and
Chief Operating Officer

John D'Arcy, Jr.
Vice Chairman

Augustin S. Hart, Jr.
Vice Chairman

Frank J. Morgan
Executive Vice President
International Grocery Products

Archibald McClure
Executive Vice President
Diversified Businesses

Luther C. McKinney
Senior Vice President—Law
Corporate Secretary

William D. Smithburg
Executive Vice President
U.S. Grocery Products

Fred D. Stone
Senior Vice President
Finance

Robert N. Thurston
Senior Vice President
Corporate Affairs

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Vice President
Corporate Purchasing

Lawrence M. Baytos
Vice President
Corporate Personnel

Joseph G. Egan
Vice President
Trade Regulations

Sam H. Flint
Vice President
Corporate Operations

Robert D. Guy
Vice President
Corporate Taxes

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Vice President and Treasurer

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Vice President and
General Counsel

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Vice President
Business Development

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Vice President and
Corporate Controller

William F. Debelak
Assistant Secretary

Louis J. Mallardi, Jr.
Assistant Secretary
Manager—Shareholder Services

Joann A. Pitcher
Assistant Secretary

Wayne H. Smith
Assistant Treasurer

Howard J. Thomas, Jr.
Assistant Secretary

Herbert E. Trenning
Assistant Treasurer

M. Gail Waller
Assistant Secretary

U.S. Grocery Products
Area

Area Staff

John F. Angeline

Vice President
Research and Development

Henry T. Chandler

Vice President
Sales and Distribution

Raymond C. Eggleston

Vice President and Controller

Felix J. Germino

Vice President
Pet Foods Research and
Development

Thomas W. Laughlin

Vice President and
Creative Director
Adcom, Inc.

Max M. Lomont

Vice President
Packaging Design

Clifford F. Lynch

Vice President
Distribution

Robert O. Nesheim

Vice President
Science and Technology

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Vice President
Personnel

D. J. Rhea

Vice President
Sales

Lois I. Ross

Vice President
Consumer Services

Dudley M. Ruch

Vice President
Marketing Research

Mitchell A. Seltzer

Vice President—Advertising
President—AdCom, Inc.

Robert E. Smith

Vice President
Human Foods Research
and Development

Joan G. Stark

Vice President and Media Director
AdCom, Inc.

Foods Division

***Jack M. Young**

President

David M. Chamberlain

Vice President and General
Manager—Frozen Foods

James W. Larson

Vice President
Product Management—Mixes,
Corn Goods, and New Areas

Douglas W. Mills

Vice President
Product Management—Cereals

Royce S. Ramsland

Vice President
Purchasing

U. B. Shockley

President
Wolf Brand Products

George J. Yapp

Vice President
Operations

Pet Foods Division

***Richard H. Glantz**

President

Hedric E. Rhodes

Vice President
Product Management

William M. Whiteford

Vice President
Purchasing

International Grocery
Products Area

***Anthony J. Dimino**

Vice President and Director
Mexican Grocery Products

***Kenneth J. Fedor**

Vice President
Business Development and
Planning—European
Grocery Products

J. Byron Felter, Jr.

Vice President and Managing
Director; Quaker Oats, Ltd.,
The United Kingdom

Jon K. Grant

President—The Quaker Oats
Company of Canada, Ltd.

William L. Jorgenson

Vice President
South and Central America

***Ronald G. Lagden**

Vice President and Director
European Grocery Products

J. A. Nelson

Vice President and Controller

David R. Nogle

Vice President
Operations

*also corporate vice president

Diversified Business Area

Area Controller

Earl K. Stigger
Vice President

Burru Division

***Alan R. Ryan**
President

John H. Horn
Vice President
Manufacturing

Chemicals Division

***Paul E. Price**
President

Andre De Bokay
Vice President
Europe

Andrew P. Dunlop
Vice President and
Scientific Advisor

A. William Haarlow
Vice President and Controller

James R. King
Vice President
Marketing Development

William J. McKillip
Vice President
Research and Development

Neal Ormond III
Vice President
Personnel

R. Bruce Sampsell
Vice President
Operations

William C. Trotter
Vice President
U.S. Chemical Marketing

Fisher-Price Toys Division

***Henry H. Coords**
President

Manuel D. Barreiro L.
Vice President and General
Manager — Plastimarx, Mexico

Franklyn S. Barry, Jr.
Vice President
Research and Development

Harvey W. Busch
Vice President
Planning and Information Systems

James H. Frank
Vice President and Controller

Robert H. Hicks
Vice President
New Ventures

Norman G. Schuller
Vice President
Engineering

James R. Tindall
Vice President
Sales and Marketing

John Zahorjan
Vice President
Operations

Magic Pan Restaurants

***Frederick D. Montgomery**
President

James J. Durkin
Vice President
Operations

Samuel T. Gentles
Vice President
Site Development

Needlecraft Division

***Lowell S. Fixler**
President

Edward R. Cowell
Vice President
Manufacturing

*also corporate vice president

Shareholder Services

The Company's Shareholder Services Department can help you with any matters concerning your Quaker common or preference stock. Feel free to write or call for any assistance you require. The address is: Shareholder Services, The Quaker Oats Company, Merchandise Mart Plaza, Chicago, Illinois 60654. Phone: (312) 222-6751.

Questions or comments on the general progress of the business are also welcomed, and should be directed to any of the senior officers listed on page 45, who can be reached at the same address.

Form 10-K

Copies of our annual report, filed each year with the Securities and Exchange Commission on Form 10-K, will be available shortly. To obtain a copy without charge, please call or write the Shareholder Services Department.

Dividend Reinvestment

The Shareholder Investment Service allows owners of Quaker common stock to purchase additional shares in the Company through automatic dividend reinvestment and/or voluntary cash investments. There is no service charge. If you'd like additional information and an authorization form, please contact the Shareholder Services Department.

Annual Meeting

The annual meeting of Quaker shareholders will be held on Wednesday, November 9, 1977, in the sixth floor assembly room at The Northern Trust Company, 50 South LaSalle Street, Chicago, Illinois. We strongly urge you to attend this meeting, which will begin promptly at 9:30 a.m. A formal notice of the meeting and all proxy materials will be mailed early in October. At the same time, proxies will be solicited by management.

Corporate Headquarters

Merchandise Mart Plaza
Chicago, Illinois 60654

U.S. Transfer Agents and Registrars

The First National Bank of Chicago
One First National Plaza
Chicago, Illinois 60670

The Chase Manhattan Bank
One Chase Manhattan Plaza
New York, New York 10015

Dividend Disbursing Agent

The First National Bank of Chicago

Shareholder Investment Service

The First National Bank of Chicago

Canadian Transfer Agent

National Trust Company, Limited
21 King Street East, Toronto, Ontario

Canadian Registrar

Crown Trust Company
302 Bay Street, Toronto, Ontario

Auditors

Arthur Andersen & Co.
69 West Washington Street
Chicago, Illinois 60602
(312) 346-6262

Shares Listed

New York Stock Exchange
Midwest Stock Exchange*
Pacific Coast Stock Exchange
The Toronto Stock Exchange
The Stock Exchange, London
Amsterdam Stock Exchange
Ticker Symbol: OAT

The Quaker Oats Company

Merchandise Mart Plaza
Chicago, Illinois 60654

